

REPORT OF THE AUDITOR-GENERAL TO THE KWA-ZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF HLABISA MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying annual financial statements of the Hlabisa Municipality which comprise the balance sheet as at 30 June 2008, income statement, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity specific basis of accounting, as set out in accounting policy note 1 to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and, Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA) and any applicable enabling legislation. This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 123 of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk

assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

8. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Basis for qualified opinion

Fixed assets

9. The fixed assets general ledger balance of R30 352 476 does not reconcile to the Fixed Asset Register amount of R26 278 680 which results in a difference of R4 073 796. Based on the Fixed Assets Register the Fixed Assets balance disclosure in the annual financial statements is overstated by the above difference.

Consequently we could not obtain sufficient and appropriate evidence regarding the accuracy and completeness of the asset register.

10. The Fixed Assets balance disclosure in the annual financial statements includes an asset that we could not verify. This asset is listed in the Fixed Assets Register at an amount of R2 900 153.

Consequently we could not obtain sufficient and appropriate evidence regarding the existence of the assets.

Provision for doubtful debt

11. We were not provided with a calculation of provision for doubtful debts. The municipality rolled forward the prior year balance. Further the municipality does not have a policy for the provision for doubtful debts. The debtors balance of R1 279 549 as disclosed in note 8 to the annual financial statements contained debtors of R786 142 which have been outstanding for more than twelve months of which no payment have been received against these debtors.

Consequently, debtors are overstated and provision for doubtful debt is understated by R786 142.

Debtors

12. The municipality has a long outstanding value added tax receivable of R5 894 533 from South African Revenue Services. We are of the opinion that the recoverability of this amount is uncertain as it is an accumulative amount from the 2003 to 2008 financial year.

Consequently, debtors is overstated and provision for doubtful debt is understated.

Unauthorised expenditure

- 13 The municipality has overspent its allocated reserves and funds by R1 470 416. This over expenditure is deemed to be unauthorised. Furthermore this over expenditure has not been disclosed correctly in the annual financial statements as it is reflected as debit balances in the reserves and funds disclosure.

Consequently expenditure is overstated and accumulated surplus is understated by R1 479 416.

Qualified opinion

14. In my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I been able to satisfy myself as to the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Hlabisa Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 to the financial statements and in the manner required by the MFMA and DORA.

Going concern

15. The municipality incurred a net loss of R4 682 901 for the year ended 30 June 2008 (2007:R6 673 918). Furthermore, the municipality's statutory funds are not adequately cash backed and the municipality is reliant on funding from equitable share to pay for its expenses in the normal course of operations. In addition, an analysis of its own income revealed that 42,5% of the municipality's income of R31,2 million is allocated to employee and consultant costs. As a result of the above the extent to which effective service delivery is achieved is questionable.
16. The statutory funds and reserves and trust funds balances of R21 783 903 are not backed by sufficient concomitant assets as required by the MFMA. The shortfall amounts to R13 306 734.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

17. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the Hlabisa Municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Fixed assets			✓		✓
Provision for doubtful debtors			✓		✓
Debtors			✓		✓
Unauthorised expenditure			✓		✓
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

Matters of governance

18. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	
<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA. 	✓	
Internal audit		
<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA. 	✓	
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA. 	✓	
<ul style="list-style-type: none"> The annual report was submitted to the auditor for consideration prior to the date of the auditor's report. 		✓
<ul style="list-style-type: none"> The financial statements submitted for audit were not subject to any material amendments resulting from the audit. 		✓
<ul style="list-style-type: none"> No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management. 	✓	
<ul style="list-style-type: none"> The prior year's external audit recommendations have been substantially implemented. 	✓	
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007. 	✓	
<ul style="list-style-type: none"> The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP. 		✓
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008. 		✓

Unaudited supplementary schedules

19. The supplementary information set out in appendix A to F does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

20. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

21. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

22. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
23. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

Audit finding (performance information)

Performance information not received

24. The municipality did not prepare a report for annual performance information as required by section 121(3)(c) of the MFMA read with section 46 of the Municipal System Act, 2000 (Act No. 32 of 2000) (MSA). Consequently the municipality's performance against any measurable performance objectives was not audited, as required by section 45(b) of the MSA and I was unable to audit this at the date of my audit report.

APPRECIATION

25. The assistance rendered by the staff of the Hlabisa municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008



A U D I T O R - G E N E R A L